

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of
HUMPHREYS FINANCE CO., INC.

Appearances:

For Appellant: Edgar W. Gibb, Attorney at Law

For Respondent: Crawford H. Thomas, Associate Tax
Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Humphreys Finance Co., Inc., to proposed assessments of additional franchise tax in the amounts of \$356.52, \$421.17 and \$594.62 for the taxable years ended July 31, 1952, 1953, and 1954, respectively.

Appellant is a California corporation whose sole business is the purchasing of conditional sales contracts from Humphreys Music Co., Inc. (hereinafter called Music Co.). Appellant and Music Co. are both owned by the same two stockholders and both have their only office in Long Beach, California. }

Music Co. sells musical instruments, radios, television sets and similar items. It receives an average of \$20,000 per month in conditional sales contracts covering the sale of these items on the installment basis. The conditional sales contracts vary between \$50.00 and \$600.00 in principal amount and total about 80 contracts per month. Appellant purchases these contracts and collects the payments, but has full recourse against Music Co. Appellant's only income is from interest on the contracts.

The question presented by this appeal is whether Appellant is properly classified as a financial corporation under Section 23183 of the Revenue and Taxation Code so that it is taxable at the rate applicable to banks and financial corporations.

The courts have enunciated two tests which must be met before a corporation may be classified as a financial corporation under Section 23183: (1) It must deal in money as

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distinguished from other commodities (Morris Plan Co. v. Johnson, 37 Cal. App. 2d 621) and (2) it must be in **substantial competition** with national banks (Crown Finance Corp. v. McColgan, 23 Cal. 2d 280).

Appellant deals in money. The disputed point is whether it is in competition with national banks. Both Respondent and Appellant submitted evidence in the form of letters from banks.

The Appellant wrote letters to the Farmers & Merchants Bank of Long Beach, the National City Bank of Long Beach and the Long Beach office of the Bank of America, asking whether those banks would purchase the conditional sales contracts from Music Co. or loan money to Music Co. with the contracts as collateral. Each of the letters described the operations of Music Co. and of Appellant with respect to the contracts and stated that the purpose of the inquiry was to obtain evidence to defend against an assessment based on a classification of Appellant as a financial corporation. In the letter to the National City Bank of Long Beach, it was stated in addition that "In connection with this question, you are advised that Humphreys Music Co. is presently indebted to local banks, who do not feel additional extensions of credit are warranted at the present **time.**"

The material portions of the replies were as follows:

(1) "At the present time this bank has loaned to Humphreys Music Company on a renewal basis the sum of \$50,000.00. We feel that this extension of credit to the Humphreys Music Co., without a further showing of resources, is about as far as we care to go at the present **time.** Thus, a further loan with the conditional contracts as collateral would not be attractive, since our previous loan to the Music Co. has considered the funds received or receivables for these same loans as a business asset.

"Insofar as purchasing the conditional sales contracts, this bank is not equipped to process loans of this **type**, as the cost of handling many of these small loans would be prohibitive." (Reply from Farmers & Merchants Bank of Long Beach.)

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(2) "In response to the informal inquiry which you have made, and based upon the statements of fact presented to us, you are advised that this bank is not interested in purchasing conditional sales contracts of this type, nor accepting them for collateral on a loan to the music company.

"We hope the above satisfactorily answers your questions, and it should not be regarded as a formal rejection." (Reply from National City Bank of Long Beach.)

(3) "In view of the statement of facts as presented by you and your outline of your methods of operations, we could not render service and financing suitable to your present requirements.

"We hope the above satisfactorily answers your question, and should ~~not be~~ regarded as a formal rejection." (Reply from Long Beach office of Bank of America.)

The Franchise Tax Board, on the other hand, addressed inquiries to the Security-First National Bank of Los Angeles, the Citizens National Trust & Savings Bank of Los Angeles, the Los Angeles office of the California Bank and the Los Angeles office of the Bank of America. Each of these letters described the operations of Music Co. and of the Appellant in connection with the contracts, giving the corporations hypothetical names, and stated that the purpose of the inquiry was to determine whether the corporation in the position of Appellant was taxable as a financial corporation. The specific questions asked, so far as here material, were: "1. Does your bank purchase conditional sales contracts, from retail dealers, covering musical instruments, radio, and TV sets? If so, is the paper purchased generally with or without recourse? 2. Does your bank make loans to retail dealers in musical instruments, radio, and TV sets, the collateral on these loans being conditional sales contracts on this type of merchandise?"

The material portions of the replies were as follows:

(1) "Our bank does purchase from previously qualified dealers on a full recourse basis conditional sales contracts covering musical instruments, radio, and TV sets.

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"Our bank makes loans to qualified retail dealers holding as collateral conditional sale contracts covering musical instruments, radio and TV sets." (Reply from Security-First National Bank of Los Angeles.)

(2) "We do have a program wherein we purchase conditional sales contracts from retail dealers covering musical instruments, radio and television sets on a full recourse basis.

"We do not make a practice of handling conditional sales contracts on the same type of merchandise as above, on a collateral basis." (Reply from Citizens National Trust & Savings Bank of Los Angeles.)

(3) "California Bank has a standard program for purchasing conditional sales contracts covering musical instruments, etc. for approved retail dealers. The paper is purchased on a full recourse basis under our standard dealer agreement . . .

"California Bank has made direct credit available to a retail dealer handling musical instruments, etc. While the conditional sales contracts are not specifically pledged to support this loan, the loan agreement requires that contracts carried be equal to at least 200% of borrowings at all times, and further provides that these contracts can be taken as collateral for the loan in the event the Bank feels credit circumstances so dictate." (Reply from Los Angeles office of California Bank.)

(4) "We do purchase conditional sales contracts and they are discounted either with or without recourse.

"We do discount conditional sales contracts either with or without recourse." (Reply from Los Angeles office of Bank of America.)

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The force of the letters which Appellant has submitted is considerably weakened by the statements in two of those letters that the replies should not be regarded as formal rejections. The implication from those statements is that the banks might have agreed to purchase the contracts if actual offers to sell them had been made and the banks had thoroughly investigated the facts. If actual offers had been made and if the Appellant had attempted to persuade the banks to accept them, rather than making it apparent that a negative answer was desired, the replies of the banks could well have been different.

It is noteworthy that of the national banks contacted By Appellant not one has indicated that it does not purchase conditional sales contracts from retail dealers. Moreover, none of the replies submitted by the Appellant, with the exception of that from the Farmers & Merchants Bank of Long Beach, give reasons why the contracts in question would not be purchased if they were offered for sale. It may be that purely temporary considerations motivated the replies, such as the statement by Appellant in its letter to the National City Bank that Music Co. was presently indebted to local banks who would not extend additional credit at that time. It is possible, also, that the banks would simply not be willing to extend as much credit or on the same terms as the Appellant. As stated by the court, however, in Crown Finance Corp. v. McColgan, supra:

"It is not logical to say that where two concerns are engaged in trading in a similar commodity (money and conditional sales contracts in the instant case) they are not in competition because one offers more favorable terms or prices than the other."

In any event, there is evidence before us that four national banks in Los Angeles do purchase conditional sales contracts as does the Appellant. In Crown Finance Corp. v. McColgan, supra, it was held that a finance company which purchased conditional sales contracts was in competition with national banks where there was evidence that a national bank in the same area--also purchased conditional sales contracts. Since the City of Los Angeles and the City of Long Beach are in close proximity and a part of the same metropolitan area they are in the same area of competition.

We conclude that Appellant is a financial corporation within the meaning of Section 23183 of the Revenue and Taxation Code,

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Appellant also contends that the legislation by which financial corporations are taxed at a higher rate than other corporations is unconstitutional. In accordance with our well-established policy, we will not pass upon the constitutionality of a statute in an appeal involving unpaid assessments, since a finding of unconstitutionality could not be reviewed by the courts. Appeal of Vortex Manufacturing Co., Cal. St. Bd. of Equal., August 4, 1933; Appeals of C. B. Hall, Sr. et al., Cal. St. Bd. of Equal., December 29, 1958 (CCH, 2 Cal. Tax Cases, Par. 201-197), (P-H St. & Loc. Tax Serv.; Cal., Par. 58,145). Cf. Appeal of Richfield Oil Corp., Cal. St. Bd. of Equal., March 2, 1950 (CCH, 1 Cal. Tax Cases, Par. 200-083), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,103).

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Humphreys Finance Co., Inc., to proposed assessments of additional franchise taxes in the amounts of \$356.52, \$421.17 and \$594.62 for the taxable years ended July 31, 1952, 1953, and 1954, respectively, be and the same is hereby sustained.

Done at Los Angeles, California, this 20th day of June, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

Richard Nevins, Member

George R. Reilly, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary